STATE OF MICHIGAN
DEPARTMENT OF ENERGY, LABOR AND ECONOMIC GROWTH
OFFICE OF FINANCIAL AND INSURANCE REGULATION

Before the Commissioner of Financial and Insurance Regulation

In the matter of:

A Blue Cross Blue Shield of Michigan Capital Contribution to Accident Fund Insurance Company of America
_____/

OFIR No. 09-015-M
Circuit Court Case No. 08-917-CZ

Issued and entered
this 8th day of May 2009
by Ken Ross
Commissioner

ORDER

I
BACKGROUND

This matter comes before the Commissioner of Financial and Insurance Regulation (Commissioner) by referral from the Ingham County Circuit Court (Case No. 08-917-CZ). In the circuit court case, the Attorney General asserted that Blue Cross Blue Shield of Michigan (BCBSM) violated the Nonprofit Health Care Corporation Reform Act (Act 350) with respect to transactions with its subsidiary, the Accident Fund Insurance Company of America (Accident Fund). Judge Paula Manderfield, in orders issued October 6, 2008 and January 13, 2009, dismissed all three counts of the Attorney General's complaint.

Count II of the complaint was dismissed without prejudice and referred to the Commissioner for resolution. In Count II, the Attorney General alleged that a $125 million capital contribution from BCBSM to the Accident Fund in November 2007 was an unlawful

subsidy that violated MCL 550.1207(1)(x)(vi), which is Section 207(1)(x)(vi) of Act 350. The Attorney General sought an order to have the funds returned to BCBSM.

On November 26, 2008, the Commissioner met with attorneys representing the Attorney General and BCBSM to discuss the issues presented by Judge Manderfield's order. Since the parties were in apparent agreement on key facts, the Commissioner encouraged them to submit stipulated facts.

Since the Accident Fund is a directly affected corporation, the Commissioner invited it to join in the informal proceedings. It accepted and participated in negotiations as to stipulated facts. The three parties did not submit an agreed-upon statement of facts, but did submit briefs arguing their positions with respect to Count II. The Attorney General submitted a request for a stay of the proceedings but, with no sufficient reason or authority presented, and with the Commissioner wanting to fully implement the referral, the Commissioner denied the request.

The Attorney General also requested a contested case hearing if the Commissioner relied on disputed facts. (AG Brief, p 15-18) None of the facts relied upon in this order are disputed facts. While the Attorney General may view the $125 million capital contribution as funds for the purchase by the Accident Fund, there were not facts presented to offset the BCBSM position that it made the capital contribution to strengthen the surplus of the Accident Fund in light of the purchase.

Thus, BCBSM's characterization of the transfer in paragraph 11 of its Opening Brief is accepted as true:

> 11. On or about August 4, 2007, the BCBSM Board of Directors approved a capital contribution from BCBSM to Accident Fund "in an amount

> sufficient to insure the collective workers' compensation companies are able to maintain an 'A' insurance rating."

This means that the capital contribution was for the purpose of strengthening surplus, and thereby bolstering its investment in a performing asset, and not for the purpose of subsidizing the Accident Fund rates or providing operating funds.

Even if there were some range of dispute as to how the transfer should be characterized, there is no authoritative source in the Insurance Code of 1956, as amended, MCL 500.100 *et seq.* (Code) or Act 350 requiring an evidentiary hearing in connection with this decision.

The Commissioner has considered the briefs of the parties, the record of the circuit court proceedings, the records of this agency, and the specialized knowledge of this agency in transactions between a parent company and its insurance company subsidiary. This order ensues.

II
THE CIRCUIT COURT REFERRAL TO THE COMMISSIONER WAS BASED UPON THE EXPERTISE OF THE AGENCY

Public Act 201 of 1993 authorized BCBSM to purchase the State Accident Fund, a workers compensation insurer which, at that time, was wholly owned by the State of Michigan. In June 1994, BCBSM created the Accident Fund as a privately held stock insurance company to assume the business of the State Accident Fund.

In November 2007, BCBSM made a capital contribution of $125 million to the Accident Fund. Shortly thereafter, the Accident Fund acquired a California workers compensation insurer,

CompWest Insurance Company (CompWest), by purchasing 100% of the outstanding shares of CWI, Inc., a Delaware holding company that owns 100% of the shares of CompWest. The purchase price was $127.4 million. The Accident Fund's purchase was completed on December 28, 2007. It is this transaction that is the subject of the Attorney General's circuit court complaint.

In her order of October 6, 2008, Judge Manderfield determined that Count II of the Attorney General's complaint would be best resolved by the Commissioner. In making this decision, Judge Manderfield relied on the doctrine of primary jurisdiction under which a court may refer a matter, initiated as civil litigation, to an administrative agency for resolution.

Primary jurisdiction is "a flexible doctrine whose invocation is largely discretionary with the trial judge." *Attorney General v Raguckas*, 84 Mich App 618, 667 (1978). Such a referral may be made where (1) the agency has specialized expertise that makes it a preferable forum for resolving the issue; (2) there is a need for uniform resolution of the issue; and (3) there is a potential for an adverse impact on the agency's ability to perform its regulatory duties should the matter be resolved by the court. *Rinaldo's Construction Co v Michigan Bell Telephone Co*, 454 Mich 65, 71 (1997).

In applying the doctrine of primary jurisdiction to the present case, Judge Manderfield stated:

> [T]he Insurance Commissioner's specialized expertise makes [OFIR] a preferable forum for resolving the issue. It is further a situation where judicial resolution of the issue may well have an adverse impact on the Commissioner's performance of his regulatory responsibilities. [Opinion and Order of October 6, 2008, p 9.]

OFIR is the only state agency with regulatory authority over nonprofit health care corporations such as BCBSM; workers compensation insurers such as the Accident Fund; and, insurance company holding systems like the BCBSM-Accident Fund arrangement. It is appropriate that a circuit court judge refer to the Commissioner civil litigation which requires extensive knowledge of these three regulatory subjects.

Judge Manderfield indicated in her order that she would likely have resolved the issue against BCBSM. However, there are at least two reasons why Judge Manderfield's discussion of Count II in her October 6 ruling was not binding on the Commissioner.

First, the ruling was made only in the context of denying BCBSM's summary motion. Her order does not contain a fully developed analysis of the issue. Second, if Judge Manderfield had intended her analysis to be dispositive of Count II, she would not have referred that matter to the Commissioner. Instead, she indicated that as to Count II she wanted the Commissioner to bring the specialized knowledge of this agency to bear on the issues.

Acting pursuant to Judge Manderfield's ruling, the Commissioner is charged with applying OFIR knowledge and expertise to determine whether the $125 million capital contribution violated Section 207(1)(x)(vi) and, if so, whether BCBSM must require the Accident Fund to return the $125 million.

III
AGENCY EXPERTISE IN REGULATING THE INSURANCE INDUSTRY

This agency has been regulating the business of insurance since the middle of the 19th Century. The first Commissioner of Insurance, Samuel H. Row, assumed his duties in 1871.

Financial solidity was the order of the day, then as now. There has always been a need for the professional assessment of the assets, liabilities, and financial transactions of insurers.

As relates to this matter, in 1912 the Legislature created, and placed under the Commissioner's supervision, the State Accident Fund. Many businesses in need of workers compensation insurance were unable to secure that coverage in the private market. The State Accident Fund, as a state owned entity, initially served as the insurer of last resort.

As things evolved in the last half of the 20th century, the State Accident Fund insured companies that could secure coverage elsewhere, but chose to buy their insurance from the State Accident Fund. Greater competition from private insurers diminished the need for the State Accident Fund to serve as the insurer of last resort. Increasingly, the book of business of the State Accident Fund resembled the book of business of an ordinary insurer. It was ripe for conversion to a private insurer under the authority of the 1993 Public Acts.

BCBSM was a child of the Great Depression. Doctors and hospitals looked for a reliable bill payer in those difficult financial times and they were influential in the creation of BCBSM, which was initially two corporations that were later put together by Act 350 in 1981. The Commissioner has always regulated BCBSM.

In what would have undoubtedly been a great surprise to the lawmakers that set the stage for BCBSM, the corporation became the dominant health insurer in Michigan in the last half of the 20th century. Through its group insurance, individual insurance, and administrative service work for self-insured groups, it writes or manages more than 60% of the health care market.

In a variety of ways, BCBSM has sought to broaden its insurance horizons in the last three decades. It was poised and ready to enter the workers compensation market with its purchase of the State Accident Fund in 1994.

In a separate development in the 1960s, insurance regulators came to understand that there was every reason to carefully oversee companies buying insurance companies and the ensuing financial transactions between the companies. Most importantly, some companies had bought insurers and stripped their assets to an extent that the acquired insurers could not meet their financial obligations to policyholders.

These concerns led to the creation of model holding company laws that were enacted in Michigan in 1970. The model laws, developed through the National Association of Insurance Commissioners, were crafted in part by Michigan Insurance Commissioner David J. Dykhouse. The model laws, which regulate acquisitions of insurers and transactions between affiliated insurers, became Chapter 13 of the Code, MCL 500.1301 *et seq.*

Thus, this agency has been intensively regulating transactions between affiliated insurers since 1970. Most pertinent to this matter is MCL 500.1341, which provides:

> (1) Transactions within a holding company system to which an insurer domiciled in this state or any foreign insurer whose written insurance premium in this state for each of the most recent 3 years exceeds the premiums written in its state of domicile and whose written premium in this state was 20% or more of its total written premium in each of the most recent 3 years is a party or with respect to which the assets or liabilities of these insurers are affected are subject to all of the following standards:
>
> (a) The terms shall be fair and reasonable.
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> * * *

(2) The commissioner's prior approval shall be required for sales, purchases, exchanges, loans, extensions of credit, or investments, involving 5% or more of the insurer's assets at the immediately preceding year's end, between a domestic controlled insurer and any person in its holding company system.

(3) A domestic insurer and any person in its holding company system shall not enter into the following transactions with each other unless the insurer has notified the commissioner in writing of its intention to enter into the transaction at least 30 days, or a shorter period as the commissioner allows, prior to entering into the transaction and the commissioner has not disapproved it within that period:

(a) Sales, purchases, exchanges, loans, extensions of credit, or investments, provided the transaction is equal to or greater than the lesser of 3% of the insurer's assets or 25% of capital and surplus as of December 31 of the immediately preceding year.

(b) Loans or extensions of credit to any person who is not an affiliate, where the insurer makes loans or extensions of credit with the agreement or understanding that the proceeds of the transactions, in whole or in substantial part, are to be used to make loans or extensions of credit to, to purchase assets of, or to make investments in, any affiliate of the insurer making the loans or extensions of credit provided the transaction is equal to or greater than the lesser of 3% of the insurer's assets or 25% of capital and surplus as of December 31 of the immediately preceding year.

(c) Reinsurance treaties or agreements.

(d) Rendering of services on a regular systematic basis.

(e) Any material transactions, specified by regulation, that the commissioner determines may adversely affect the interests of the insurer's policyholders.

* * *

BCBSM, regulated by Act 350, is not directly governed by Section 1341. Thus, while the $125 million capital contribution from BCBSM was not subject to the approval of the Commissioner, the Accident Fund, which is subject to Section 1341, reported it to the agency as well as its acquisition of CompWest. The Accident Fund was required to seek prior approval of the

CompWest purchase from the California Commissioner of Insurance under California's similar holding company laws.

While the $125 million capital contribution from BCBSM was not subject to agency approval, what is critical is that the agency reviews this sort of transaction with regularity. It has 17 accountants that spend time each year reviewing inter-company capital contributions. The agency reviewed over 50 capital contributions in the past three years.

This agency, through its regular scrutiny of capital contributions, is in an excellent position to assess whether the $125 million capital contribution at issue amounted to a subsidy, a transfer for operating expenses, or another form of financial transaction for the purposes of Section 207(1)(x)(vi).

IV
ANALYSIS

A. The Principal Allegations of the Attorney General

The allegations brought by the Attorney General in Count II are stated in paragraphs 45 and 46 of the Attorney General's circuit court complaint:

> 45. Blue Cross made the $125 million capital contribution to the Accident Fund (with the express approval of Blue Cross' Board of Directors) for the purpose of funding the Accident Fund's acquisition of CWI/CompWest. As such, Blue Cross used company funds to operate the Accident Fund in violation of MCL 550.1207(1)(x)(vi) by, among other ways: (a) performing the funding function; (b) exerting the power or influence necessary to secure the acquisition of CWI/CompWest; and (c) producing the desired outcome or effect, i.e., ensuring the Accident Fund's successful acquisition of CWI/CompWest.
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> 46. Blue Cross is not authorized to use (and is in fact expressly prohibited from using) company or subscriber funds to operate or subsidize the Accident Fund in any way, including but not limited to making capital contributions to the Accident Fund to enable it to acquire CWI/CompWest or any other insurance company.

Section 207(1)(x)(vi), which lies at the center of this dispute, provides:

> (1) A health care corporation, subject to any limitation provided in this act, in any other statute of this state, or in its articles of incorporation, may do any or all of the following:
>
> * * *
>
> (x) Notwithstanding subdivision (o) or any other provision of this act, establish, own, and operate a domestic stock insurance company only for the purpose of acquiring, owning, and operating the state accident fund pursuant to chapter 51 of the insurance code of 1956, 1956 PA 218, MCL 500.5100 to 500.5114, so long as all of the following are met:
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> * * *
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> (vi) Health care corporation and subscriber funds are not used to operate or subsidize in any way the insurer including the use of such funds to subsidize contracts for goods and services. This subparagraph does not prohibit joint undertakings between the health care corporation and the insurer to take advantage of economies of scale or arm's-length loans or other financial transactions between the health care corporation and the insurer.

The central issue of this case is whether the November 2007 capital contribution constitutes BCBSM operating or subsidizing the Accident Fund as proscribed by Section 207(1)(x)(vi) or whether the capital contribution is an "other financial transaction" permitted by that section.

B. Three Public Acts Underlying the Dispute

Section 207(1)(x)(vi) appears in one of three Public Acts passed in 1993 under which BCBSM acquired the State Accident Fund. The 1993 Acts amended the Workers Disability Compensation Act, the BCBSM Act, and the Insurance Code. These Acts are germane to this matter:

- PA 198 (SB 51) – Amended the Workers Disability Compensation Act, authorizing the sale of the State Accident Fund.

- PA 200 (SB 346) – Amended parts of the Insurance Code and created Chapter 51 of the Insurance Code ("Organization of an Acquiring Insurer or Transaction of Certain Types of Insurance"). This Act contains detailed requirements for establishing and approving workers compensation rates, in the event that the insurer acquiring the State Accident Fund was controlled by BCBSM.

- PA 201 (SB 568) – Amended Section 207 of Act 350 to permit a nonprofit health care corporation to own a domestic stock insurance company to acquire the State Accident Fund. Enactment of this statute was conditioned on the passage of PA 200, above. It is Section 207(1)(x) of this Act which the AG alleges was violated by the November 2007 fund capital contribution.

The Attorney General asserts that any movement of BCBSM funds to the Accident Fund not explicitly authorized by Section 207(1)(x)(vi) is prohibited. BCBSM argues that it may make a capital contribution to the Accident Fund so long as the funds are not used to reduce the Accident Fund's workers compensation rates to the detriment of other workers compensation insurers. For the reasons set forth below, the Commissioner concludes that the November 2007 capital contribution did not violate Section 207(1)(x)(vi).

C. The Definitions of the Key Terms Used in Section 207(1)(x)(vi) Show that the Capital Contribution was Authorized Under that Section.

In order to determine whether Section 207(1)(x)(vi) has been violated, it is necessary to understand several terms used in that section: "subsidize," "operate," and "other financial transactions." The legislature did not provide definitions for these terms when it created Section 207(1)(x)(vi).

The lynchpin of the Attorney General's position is that the $125 million capital contribution was a subsidy to the Accident Fund. The Attorney General argues that, in the absence of statutory definitions, the *Merriam-Webster Collegiate Dictionary* definition of "subsidize" and "operate" must be employed. In contrast, BCBSM argues that these terms have

special definitions derived from the fact that they are employed in the statute in the context of workers compensation rate setting. The Attorney General further argues that the meaning of "other financial transactions" is limited. BCBSM, of course, would give a broad reading to this phrase.

1. "Subsidize" is a technical term in the business of insurance and its technical definition governs this dispute.

What "subsidize" means lies at the heart of the Attorney General's contentions.

Subsidize has an insurance industry-specific meaning. The term is defined in Barron's *Dictionary of Insurance Terms* as the "difference between the ACTUARIAL EQUIVALENT (rate) and the often lower rate actually charged to insure a risk." ("Actuarial equivalent" is a "mathematical determination based on the expectation of loss and the benefits to be paid in such an eventuality. The premium charged will vary directly with the probability of loss.") Thus, "subsidy" in the insurance industry refers to the relationship between premiums and expected losses.

While the Attorney General argues for a broad dictionary definition of "subsidize," statutory and judicial standards for the construction of statutes mandate that technical terms shall be construed in their technical sense. MCL 8.3a provides:

> All words and phrases shall be construed and understood according to the common and approved usage of the language; but technical words and phrases, and such as may have acquired a peculiar and appropriate meaning in the law, shall be construed and understood according to such peculiar and appropriate meaning.

As expected, there has been an abundance of appellate court cases drawing upon and adhering to this statutory standard, one recent example being *People v. Blunt*, 282 Mich App 81, 83 (2009).

The commonness and soundness of this principle is underscored by the Michigan Supreme Court applying it to constitutional interpretations, *Michigan Coalition of State Employee Unions v. Michigan Civil Service Commission*, 465 Mich. 212, 222 (2001), and the United State Supreme Court applying it in the construction of federal statutes, *Corning Glass Works v. Brennan*, 417 U.S. 188, 201 (1974).

2. From the inception of the unified BCBSM, the Legislature recognized and utilized "subsidy" in its rate-related technical sense in Act 350.

Act 350, passed in 1980, became law in 1981. In the original act, the Legislature made a significant use of the term "subsidy." The Legislature used the term in the context of setting rates. MCL 550.1436 provides:

> There may be created within each health care corporation a Michigan caring program for children. The program shall provide primary health care coverage for children as set forth in section 438 and shall be administered by the health care corporation. Each program shall be described in a certificate that sets forth the benefits provided. A certificate and the contribution to be charged shall be subject to the commissioner's approval. Contribution requirements shall be established in accordance with rating methodologies approved by the commissioner which, over time, shall not result in either gain or loss to the corporation. *The rating methodology for a program shall not include any factors otherwise includable pursuant to other sections of this act that are intended to provide for subsidies, surcharges, or administrative costs.* Any other provisions of this act that would otherwise apply to a program but which are inconsistent with the provisions of this section and sections 437 to 439 are superseded. [Emphasis added.]

This has reference to MCL 550.1609(5), where, as an exception to the requirement that rates for each line of business must be self-sustaining—meaning no subsidy—BCBSM was authorized to use its funds to subsidize certain rates through capital contributions:

> Except for identified cost capital contributions, each line of business, over time, shall be self-sustaining. However, there may be cost capital contributions for the benefit of senior citizens and group conversion subscribers. Cost capital contributions for the benefit of senior citizens, in the aggregate, annually shall not exceed 1% of the earned subscription income of the health care corporation as reported in the most recent annual statement of the corporation. Group conversion subscribers are those who have maintained coverage with the health care corporation on an individual basis after leaving a subscriber group.

Thus, the Legislature has been mindful of, and carefully controlled, subsidies in rates, as it did in the original act in 1980 and later in Section 207(1)(x)(vi) in 1993 by prohibiting BCBSM from using its resources to subsidize the Accident Fund rates.

3. Legislative history shows a major concern was that BCBSM, after acquiring the Accident Fund, could use its resources to subsidize Accident Fund rates, thereby driving out competition. The $125 million capital contribution was a transfer to strengthen surplus, not a transfer to subsidize Accident Fund rates.

The influence that BCBSM might exert on the Accident Fund premium rates was a significant legislative concern when the Accident Fund privatization statutes were being drafted. The Legislature in Public Act 200 of 1993 detailed how rates were to be established and regulated should BCBSM become the purchaser of the State Accident Fund. See MCL 500.2403, 500.2406, and 500.2420.

There are no similar restrictions in those Acts which would apply if some other insurer purchased the State Accident Fund. The Acts demonstrate that the Legislature believed there

were circumstances unique to BCBSM as a potential purchaser that warranted additional restrictions on BCBSM when acting as the Accident Fund's parent.

A September 15, 1993, analysis prepared by the House Legislative Analysis Section summarized the arguments supporting and opposing the privatization bills. The pertinent section of that analysis (pages 9-10) is set forth in full below, with emphasis added:

> **Against:**
>
> While privatizing the fund may be a good idea, allowing [BCBSM] to enter the bidding process with the possible goal of buying the fund, as Senate Bill 568 would permit, goes against the whole idea of privatization. Simply put, BCBSM is not a private company. It was created by the legislature under Public Act 350 of 1980 and is subject to political manipulation of its rates and business activities just as is the accident fund now. *If BCBSM were allowed to bid on the fund, it probably would offer the highest bid. And if it were to buy the fund, it could – by virtue of its current dominance in the health care market – leverage its buying power with health care providers to effectively undercut private worker's compensation carriers. Assuming it owned the fund, BCBSM could artificially reduce the rates charged for worker's compensation insurance, subsidized via its health care operations, in order to put other carriers out of business and eventually monopolize the market; rates, of course, eventually would rise as fewer carriers wrote policies.* On the other hand, allowing BCBSM to venture into another insurance market could harm its primary mission of acting as a quasi-governmental health care insurance carrier. It seems odd that the state would create an agency like BCBSM and strictly limits its scope of operations, and then reverse itself by allowing the Blues to act as a private worker's compensation insurance carrier. Also, what assets would BCBSM use to purchase the fund? It's supposed to be a nonprofit corporation, and any reserves it has are statutorily required to be at a level appropriate solely to pay its claims and other expenses. If BCBSM now believes it has enough "extra money" in reserves or elsewhere to purchase the accident fund, does that not suggest that it may have been and still is overcharging its subscribers?
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> **Response:**
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> *A number of provisions were added to the House committee substitute for Senate Bill 568 that would prevent BCBSM from acting unscrupulously if it were to buy the fund. Language was added that specifically would prohibit BCBSM from subsidizing its worker's compensation rates, and that would require it to submit certain information about its rates to the insurance commissioner. In addition,*

> *the substitute would allow other insurance carriers to bring a contested case hearing against BCBSM if they felt its rates were too low.* With these protections added to Senate Bill 568, the state could be assured that proper oversight of BCBSM would exist if it were to purchase the fund. More importantly, however, it would be certain to receive hundreds of millions of dollars more from selling the fund that it otherwise might if BCSBM were not allowed to bid.

The language of Section 207(1)(x)(vi) and the analysis quoted above demonstrate that the Legislature was careful to ensure that the economic power of BCBSM would not be wielded to enhance the Accident Fund's influence in the workers compensation marketplace. The Attorney General's complaint and subsequent briefs have not established a different rationale for the restrictions of Section 207(1)(x)(vi).

In the 15 years since privatization, no complaint has been filed with the Commissioner by a workers compensation insurer claiming that the Accident Fund rates have been too low, even though MCL 500.2420(3) created a process for receiving and adjudicating such complaints. This shows that the special rate provisions of Public Act 200 have been successful in preventing the use of BCBSM's economic power to improperly influence workers compensation rates.

4. **The Business Plan submitted by BCBSM to the State of Michigan in 1994 demonstrates that all parties, including the Attorney General who represented the State, understood that capital contributions of BCBSM funds to strengthen the surplus of the Accident Fund were an obligation where needed. This establishes that capital contributions to strengthen surplus would not be understood to be subsidies or operating expenses prohibited by Section 207(1)(x)(vi).**

In connection with its bid to purchase the State Accident Fund, BCBSM submitted a five-year Business Plan to the State of Michigan. See Complaint, Exhibit A. On page two of the Business Plan, BCBSM represented to the State of Michigan that:

> [BSBSM] plans to keep the Accident Fund financially strong by allowing earnings to accumulate in the [Accident] Fund until statutory surplus is adequate to obtain an A rating by A.M. Best and [BCBSM] is prepared to make capital contributions to the Accident Fund from its general assets in the form of surplus notes in the early years to maintain an acceptable writing to surplus ratio.

On page 6 of the Business Plan, BCBSM similarly represented to the State of Michigan that BCBSM would make contributions to the Accident Fund in the form of surplus notes in order to maintain adequate surplus, the Accident Fund's A.M. Best rating, and a net premiums written to surplus ratio of 1.5 to 1.

5. **The Asset Purchase Agreement entered into by BCBSM in its acquisition of the Accident Fund obligated BCBSM for a period of seven years to use its funds to strengthen the surplus of the Accident Fund if needed. The Attorney General, representing the State, reviewed this agreement. This shows that capital contributions to strengthen surplus were not understood to be subsidies or operating expenses prohibited by Section 207(1)(x)(vi).**

To complete the sale of the State Accident Fund, BCBSM, as the Bidder, the State of Michigan, as the Seller, and the Accident Fund, as the Buyer, entered into an Asset Purchase Agreement dated June 15, 1994 (Agreement), and a First Amendment to the Agreement dated December 28, 1994. See Complaint at Exhibit B. Section 8(o) of the Agreement provided that:

> [S]o long as [BCBSM] is Controlling Affiliate of [Accident Fund], [BCBSM] shall make contributions to [Accident Fund] from [BCBSM]'s general assets in the form of surplus notes, to the extent permitted by law and with the prior approval of the Michigan Commissioner of Insurance, sufficient to create and maintain, at all times, [Accident Fund]'s ratio of net written premium to surplus at a level less than or equal to one and one-half to one (1.5 : 1). [See Complaint at Exhibit B.]

It was a condition of the sale that BCBSM would for a period of seven years make capital contributions to the Accident Fund as needed to strengthen surplus. This was the commitment that BCBSM made to the State of Michigan.

6. Expert agency analysis of capital contributions between insurers in general confirms that the $125 million capital contribution was not a subsidy or a transfer for operating expenses under Section 207(1)(x)(vi). It was, instead, an investment that falls under "other financial transaction" in Section 207(1)(x)(vi).

This agency has devoted substantial resources to evaluate inter-company financial transactions under Section 1341, quoted above. It has a workforce of 17 accountants that analyze a variety of transactions, including extraordinary dividends, service contracts, land sales, and capital contributions. These accountants, after joining OFIR, mentor for years with more experienced staff members. This careful training builds a specialized knowledge in insurance accounting.

This specialized knowledge is necessary because the business of insurance has many unique facets and because, while most businesses are regulated under General Accounting Accepted Principles (GAAP), the insurance industry, for most purposes, is governed by the Statutory Accounting Principles (SAP). Overall, SAP is more conservative than GAAP as to assets and liabilities given that the primary mission of insurance regulation is keeping insurers financially sound so that they can meet their duty to pay claims, many of which arise years after a policy is purchased.

The staff has reviewed over 50 capital contributions reported under Section 1341 in the past three years. It has a deep working knowledge of subsidies, operating expenses, and

financial transactions in general, especially capital contributions. As noted, the BCBSM capital contribution was not subject to approval since this transaction was regulated under Section 207(1)(x)(vi), but the staff's insight on key terms used in that section is invaluable.

Rather than a subsidy, OFIR views the November 2007 capital contribution as a shifting back of funds or capital that was previously paid to BCBSM by the Accident Fund. BCBSM returning capital back to the Accident Fund is an efficient and effective use of capital within the holding company. In holding company systems, capital is often shifted among member companies in order to maximize the return on equity. This capital movement is preferable to obtaining a loan from an outside lender because interest charges can be minimized and retained within the holding company system rather than being paid to an outside entity.

The $125 million capital contribution allowed the Accident Fund to maintain a favorable rating with outside rating agencies. The Accident Fund could have made the purchase of CompWest without the capital contribution of funds from BCBSM and the purchase would have likely been approved by California insurance regulators. The decision to have the additional capital is typical of insurers who prefer to maintain a high rating in order to afford agents and policyholders an additional comfort level.

As to operating funds, in accounting, they are different than capital funds. Operating funds flow out of an insurer to meet its business obligations. Capital funds are retained as a reserve for dividend distribution, to satisfy regulatory requirements, or to maintain a favorable rating with rating agencies in order to be viewed favorably by investors and policyholders.

In summary, in the staff's expert opinion, the transfer was not used to "operate" or "subsidize" the Accident Fund. It was, instead, a "financial transaction" designed to achieve, and achieving, the strengthening of the Accident Fund's surplus. This strengthening was correctly reflected in the quarterly and annual statements of the Accident Fund.

Capital contributions from a parent to its insurance subsidiary to strengthen surplus, and thus enhance its investment in the subsidiary, are commonplace. The transfer at issue here, had it been subject to Section 1341, would not even had required the Commissioner's approval, given the commanding assets of BCBSM and its capital and surplus as of December 31, 1993.

7. **The history of transfers of funds between BCBSM and the Accident Fund from 1994 through 2007 establishes that the Accident Fund, up to the transfer at issue, had transferred $144.8 million more in funds to BCBSM than BCBSM transferred to it. Even taking into account the $125 million capital contribution in November 2007, the Accident Fund remained ahead in transfers by $19.8 million. This makes it clear that, collectively, over the duration of their affiliation, BCBSM has not subsidized the Accident Fund as proscribed by Section 207(1)(x)(vi).**

The Attorney General has taken a single movement of funds from BCBSM to the Accident Fund and claimed that it was a gift of funds. However, over the lifetime of the BCBSM-Accident Fund relationship, there have been numerous monetary transactions between the two entities. Ten transactions occurred before the $125 million transaction:

1.	1994	BC to AF	$10,000,000	stock purchase
2.	1995	BC to AF	$40,000,000	surplus contribution [1]
3.	1999	AF to BC	$100,000,000	shareholder dividend
4.	2000	AF to BC	$35,000,000	shareholder dividend
5.	2000	BC to AF	$200,000	capital contribution [2]
6.	2001	AF to BC	$33,000,000	shareholder dividend
7.	2002	AF to BC	$1,800,000	shareholder dividend
8.	2002	BC to AF	$1,800,000	capital contribution [2]
9.	2006	AF to BC	$15,000,000	shareholder dividend

10.	2007	AF to BC	$12,000,000	shareholder dividend
11.	2007	BC to AF	$125,000,000	capital contribution

[1] Repaid with interest in 1996 and 1997.
[2] Required by non-Michigan regulators.

The net effect of these transactions is that, since the initial purchase, the Accident Fund had furnished to BCBSM $19.8 million more than the Accident Fund had received from BCBSM. Moreover, before the $125 million transaction, the Accident Fund had sent to BCBSM $144.8 million more than BCBSM had transferred to the Accident Fund.

The Attorney General's preferred definition of subsidy as a "non-repayable gift" (AG Brief, p 6) does not reflect the reality of the BCBSM-Accident Fund relationship. BCBSM has always had the expectation of a return on its investment in the Accident Fund. This expectation has been realized, as shown above. BCBSM has received dividends from the Accident Fund which are well in excess of the money BCBSM has invested in the Accident Fund. An investment is not a gift or subsidy, under any definition.

IV
FINDINGS OF FACT

The Parties

1. BCBSM is a nonprofit health care corporation governed by the Nonprofit Health Care Corporation Reform Act, MCL 550.1101, *et seq,* referred to as Act 350

2. The Accident Fund is a Michigan domestic insurer, formed pursuant to chapter 51 of the Michigan Insurance Code.

3. The Attorney General is broadly authorized by the Michigan Constitution of 1963 to initiate litigation on behalf of the public to secure the enforcement of state laws.

The Circuit Court Case and the Referral

4. This matter comes before the Commissioner by referral from the Ingham County Circuit Court (Case No. 08-917-CZ).

5. In the circuit court case, the Attorney General asserted that BCBSM violated Act 350 with respect to transactions with its subsidiary, the Accident Fund.

6. Count II of the complaint was dismissed without prejudice and referred to the Commissioner for resolution. In Count II, the Attorney General alleged that a $125 million capital contribution from BCBSM to the Accident Fund in November 2007 was an unlawful subsidy that violated MCL 550.1207(1)(x)(vi), which is Section 207(1)(x)(vi) of Act 350. The Attorney General sought an order to have the funds returned to BCBSM.

7. In her order of October 6, 2008, Judge Manderfield determined that Count II of the Attorney General's complaint would be best resolved by the Commissioner. In making this decision, Judge Manderfield relied on the doctrine of primary jurisdiction under which a court may refer a matter, initiated as civil litigation, to an administrative agency for resolution.

8. In applying the doctrine of primary jurisdiction to the present case, Judge Manderfield stated:

> [T]he Insurance Commissioner's specialized expertise makes [OFIR] a preferable forum for resolving the issue. It is further a situation where judicial resolution of the issue may well have an adverse impact on the Commissioner's performance of his regulatory responsibilities. [Opinion and Order of October 6, 2008, p 9.]

9. Since the Accident Fund is a directly affected corporation, the Commissioner invited it to join in the informal proceedings. It accepted and participated in negotiations as to stipulated facts and submitted a brief.

Statutes Leading to the Acquisition

10. Public Act 198 of 1993 amended the Workers Disability Compensation Act and authorized the sale of the State Accident Fund.

11. Public Act 200 of 1993 created chapter 51 of the Michigan Insurance Code which established procedures for setting workers compensation rates in the event that the State Accident Fund was purchased by BCBSM.

12. Public Act 201 of 1993 made additions to Section 207 of Act 350 to permit BCBSM to create, own, and operate a domestic stock insurance company to acquire the State Accident Fund. Section 207 additions also described the authority of BCBSM in acting as the parent of the insurer which acquired the State Accident Fund.

Expertise of the Agency

13. This agency has been regulating the business of insurance since the middle of the 19th Century.

14. In 1912, the Legislature created, and placed under the Commissioner's supervision, the State Accident Fund.

15. BCBSM was initially two corporations that were later put together by Act 350 in 1981. The Commissioner has always regulated BCBSM.

16. Model holding company laws were enacted in Michigan in 1970. The model laws, developed through the National Association of Insurance Commissioners, were crafted in part by Michigan Insurance Commissioner David J. Dykhouse. These model laws regulate the acquisitions of insurers and transactions between affiliated insurers.

17. This agency has been intensively regulating transactions between affiliated insurers since 1970, principally through its enforcement of MCL 500.1341.

18. BCBSM, regulated by Act 350, is not directly governed by Section 1341.

19. While the $125 million capital contribution from BCBSM was not subject to agency approval, what is critical is that the agency reviews this sort of transaction with regularity. It has 17 accountants that spend time each year reviewing inter-company capital contributions. The agency reviewed over 50 capital contributions in the past three years.

20. This agency, through its regular scrutiny of capital contributions, is in an excellent position to assess whether the $125 million capital contribution at issue amounted to a subsidy, a transfer for operating expenses, or another form of financial transaction for the purposes of Section 207(1)(x)(vi).

Steps in the Acquisition

21. Following passage of Public Act 201 of 1993, BCBSM created a wholly-owned subsidiary stock insurance company, the Accident Fund Company, to acquire the State Accident Fund. The Accident Fund Company was later renamed the Accident Fund Insurance Company of America.

22. On June 15, 1994, the State of Michigan, BCBSM, and the Accident Fund executed an Asset Purchase Agreement under which the Accident Fund would acquire the State Accident Fund. This Agreement was amended December 28, 1994. A business plan was part of the agreement.

23. On November 13, 2007, BCBSM made a capital contribution of $125 million to the Accident Fund.

24. On November 20, 2007, the Accident Fund acquired 100% of the outstanding shares of CWI Holdings, Inc., a Delaware insurance holding company that owns 100% of the shares of CompWest Insurance Company, a California property and casualty insurance company writing workers compensation insurance, primarily in California. The Accident Fund paid $127.4 million for CWI Holdings.

25. On December 28, 1994, the Accident Fund completed its purchase of the State Accident Fund.

Principal Findings

26. The definitions of the key terms used in Section 207(1)(x)(vi) show that the capital contribution was authorized under that section.

27. "Subsidize" is a technical term in the business of insurance and its technical definition governs this dispute.

28. Subsidize has an insurance industry-specific meaning. The term is defined in Barron's *Dictionary of Insurance Terms* as the "difference between the ACTUARIAL EQUIVALENT (rate) and the often lower rate actually charged to insure a risk." ("Actuarial equivalent" is a "mathematical determination based on the expectation of loss and the benefits to be paid in such an eventuality. The premium charged will vary directly with the probability of loss.") Thus, "subsidy" in the insurance industry refers to the relationship between premiums and expected losses.

29. From the inception of the unified BCBSM, the Legislature recognized and utilized "subsidy" in its rate-related technical sense in Act 350.

30. Act 350, passed in 1980, became law in 1981. In the original act, the Legislature made a significant use of the term "subsidy." The Legislature used the term in the context of setting rates.

31. Legislative history shows a major concern was that BCBSM, after acquiring the Accident Fund, could use its resources to subsidize Accident Fund rates, thereby driving out competition. The $125 million capital contribution was a transfer to strengthen surplus, not a transfer to subsidize Accident Fund rates.

32. In the 15 years since privatization, no complaint has been filed with the Commissioner by a workers compensation insurer claiming that Accident Fund rates have been too low, even though MCL 500.2420(3) created a process for receiving and adjudicating such complaints. This shows that the special rate provisions of Public Act 200 have been successful in preventing the use of BCBSM's economic power to improperly influence workers compensation rates.

33. The Business Plan submitted by BCBSM to the State of Michigan in 1994 demonstrates that all parties, including the Attorney General who represented the State, understood that capital contributions of BCBSM funds to strengthen the surplus of the Accident Fund were an obligation where needed. This establishes that capital contributions to strengthen surplus would not be understood to be subsidies or operating expenses prohibited by Section 207(1)(x)(vi).

34. On page 6 of the Business Plan, BCBSM similarly represented to the State of Michigan that BCBSM would make contributions to the Accident Fund in the form of surplus notes in order to maintain adequate surplus, Accidents Fund's A.M. Best rating, and a net premiums written to surplus ratio of 1.5 to 1.

35. The Asset Purchase Agreement entered into by BCBSM in its acquisition of the Accident Fund obligated BCBSM for a period of seven years to use its funds to strengthen the surplus of the Accident Fund if needed. The Attorney General, representing the State, reviewed this agreement. This shows that capital contributions to strengthen surplus were not understood to be subsidies or operating expenses prohibited by Section 207(1)(x)(vi).

36. In November 2007, the Accident Fund had access to assets sufficient to purchase CompWest without obtaining any funds from BCBSM.

37. Expert agency analysis of capital contributions between insurers in general confirms that the $125 million capital contribution was not a subsidy or a transfer for operating expenses under Section 207(1)(x)(vi). It was, instead, an investment that falls under "other financial transaction" in Section 207(1)(x)(vi).

38. The $125 million capital contribution allowed the Accident Fund to maintain a favorable rating with outside rating agencies.

39. Operating funds, in accounting, are different than capital funds. Operating funds flow out of an insurer to meet its business obligations. Capital funds are retained as a reserve for dividend distribution, to satisfy regulatory requirements, or to maintain a favorable rating with rating agencies in order to be viewed favorably by investors and policyholders.

40. Capital contributions from a parent to its insurance subsidiary to strengthen surplus, and thus enhance its investment in the subsidiary, are commonplace.

41. The history of transfers of funds between BCBSM and the Accident Fund from 1994 through 2007 establishes that the Accident Fund, up to the transfer at issue, had transferred $144.8 million more in funds to BCBSM than BCBSM transferred to it. Even taking into account the $125 million capital contribution in November 2007, the Accident Fund remained ahead in transfers by $19.8 million. This makes it clear that, collectively, over the duration of their affiliation, BCBSM has not subsidized the Accident Fund as proscribed by Section 207(1)(x)(vi).

42. The capital contribution was for the purpose of strengthening surplus, and thereby bolstering its investment in a performing asset, and not for the purpose of subsidizing Accident Fund rates or providing operating funds.

V
CONCLUSIONS OF LAW

Based upon the foregoing analysis, the Commissioner concludes that:

1. There is no authority in Act 350 providing for a formal hearing in deciding this matter. The parties have had a fair and ample opportunity to present facts and argue laws in their briefs.

2. This dispute is governed by Section 207(1)(x)(vi).

3. Technical terms used in statutes are to be construed and applied in their technical sense according to MCL 8.3a. That includes "subsidy," "operate," and "other financial transactions," used in Section 207(1)(x)(vi).

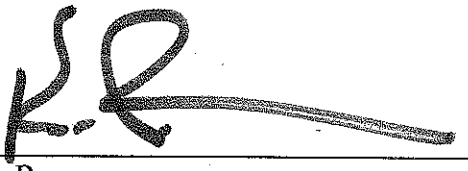
4. BCBSM did not violate Section 207(1)(x)(vi) in its November 2007 capital contribution to the Accident Fund.

VI
ORDER

Therefore, it is ORDERED that:

1. The November 2007, capital contribution is not set aside; and

2. BCBSM is not required to direct the Accident Fund to repay BCBSM's November 2007 capital contribution.



Ken Ross
Commissioner